

STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

Illinois-American Water Company)	
)	Docket No. 11-0767
Proposed General Increase in Water)	
and Sewer Rates.)	

REPLY BRIEF OF THE INTERVENOR, THE VILLAGE OF BOLINGBROOK

Now comes the Intervenor, the Village of Bolingbrook, by its attorneys, Tressler LLP, and, for its Reply Brief, states:

INTRODUCTION

Without providing any explanation, rationale, or, more importantly, evidence, ILLINOIS-AMERICAN WATER COMPANY (“IAWC” or “Company”) requests that this Court approve a consolidation of Chicago Metro Water District into Zone 1. In light of the lack of evidence, this Commission should deny this request.

Further, IAWC seeks to include in its rate base \$27.5 million the cost of three new business systems, which IAWC’s parent, American Water Company, calls the “Business Transformation” or “BT” project.¹ These amounts should **not** be included in the rate base because the BT project provides the same functions as provided for IAWC by its American Water Service Company (“Service Company”). Treating the BT costs as IAWC rate base

¹ See IAWC Ex. 4.00 at 2-6 and IAWC Ex. 4.01.

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violates the terms of the Service Company agreement with IAWC, which is approved by this Commission in light of the relatedness of the two companies.

This Commission should also reject IAWC's request for the imposition of a "Revenue Adjustment Clause" rider ("RAC"), which guarantees IAWC's a certain amount of revenues regardless of the water that IAWC actually delivers and sells. This radical concept should summarily be rejected.

Because of severe concerns about the enormous increases in recent years from the Service Company, the Commission required an audit of IAWC's Service Company fees. In this proceeding, IAWC has failed to prove that the total amount of the costs it incurred, and that its Service Company incurred, in relation to the audit should be included as part of the rate basis.

Finally, Bolingbrook adopts the Attorney General's positions on IAWC's tax returns. IAWC files a consolidated tax return at the parent level, and its parent has no taxable income. Thus, IAWC is not taking advantage of the "Section 199" deduction. Further, this Commission should follow the lead of other states' commissions and implement a mechanism to capture consolidated tax savings for Illinois consumers, particularly where IAWC has failed to take advantage of available tax savings in Illinois.

ARGUMENT

I. The Commission Should Reject IAWC's Attempt to Consolidate the Chicago Metro Water District with Zone 1.

IAWC's attempt to consolidate the Chicago Metro Water District with Zone 1 district should be rejected. IAWC urges that the consolidation should be approved because it moves "IAWC's rates towards single tariff pricing." (IAWC Initial Brief at p. 98). That is an

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insufficient reason for instituting such a large change to the current system that will impact Chicago Metro users for decades to come.

The Public Utilities Act (“Act”) “requires the Commission to establish ‘just and reasonable’ rates.” Commonwealth Edison Co. v. Illinois Commerce Commission, 405 Ill.App.3d 389, 937 N.E.2d 685 (2d Dist. 2010); 220 ILCS 5/9-101. A utility company like IAWC may not unilaterally make a change in “any rate or other charge or **classification**, or in any rule, regulation, practice or contract relating to or affecting any rate or other charge, classification or service” without first giving notice to the ICC and the public. 220 ILCS 5/9-201(a) (Emphasis added); Illinois Bell Telephone Co. v. Illinois Commerce Commission, 327 Ill.App.3d 768, 762 N.E.2d 1117 (3d Dist. 2002). Further:

A determination of what is ‘just and reasonable’ involves a balancing by the Commission of the interests of the utilities’ stockholders and the utilities’ consumers. [Citation]. ‘The Commission cannot fulfill its statutory duty to balance the competing interests of stockholders and ratepayers without taking into account the interests of ratepayers by considering the impact of proposed rates on ratepayers. [Citation].

Abbott Laboratories, Inc. v. Illinois Commerce Commission, 289 Ill.App.3d 705, 682 N.E.2d 340 (2d Dist. 1998) (Citations omitted). “[I]f the rightful expectations of the investor are not compatible with those of the consuming public, it is the latter which must prevail.” Citizens Utility Board v. Illinois Commerce Commission, 276 Ill.App.3d 730, 658 N.E.2d 1235 (1st Dist. 1995) (Quotations omitted). In sum, IAWC shoulders the burden of establishing in this proceeding that its proposed consolidation of the Chicago Metro Water District with Zone 1 is in the best interests of Illinois ratepayers.

IAWC has completely failed to carry its burden in this regard. In its October 27, 2011, letter from Edward Grubb to the ICC that filed IAWC's proposed tariff including its rate increase, IAWC asserts that this proposed consolidation is for "non-production related costs." Its "non-production related costs" were not defined, nor was any sufficient testimony or evidence presented to the Commission in this proceeding that the proposed consolidation is in the best interests of Illinois ratepayers. Indeed, Chicago Metro Water District is markedly different than the Zone 1 service area in that Chicago Metro is a purchased Lake Michigan water area, whereas Zone 1 is largely not a purchased water area and involves substantial water treatment costs. Further, there was no analysis by the Company presented to the Commission regarding the impact that the proposed consolidation may have, including discussion regarding the infrastructure improvements made or needed in Zone 1 compared to those made or needed in Chicago Metro.

Indeed, as noted by IWC and FEA, the proposed consolidation should be rejected because it ignores the concept of consolidation, the geographical distinctness of each service area, and the different zonal class structures. (IWC/FEA Ex. 4.0 (Collins Reb.), pp. 2-3). The consolidation would thus erode system efficiency by creating subsidies between the two districts. (Id. at p. 4). The striking differences between Chicago Metro and Zone 1 are worth noting: as determined by A.G. witness Scott Rubin from his analysis of IAWC's own data, residential production costs in Zone 1 (\$0.5243 per 1,000 gallons under IAWC's proposed rates) are dramatically higher than in Chicago Metro (\$0.0988 per 1,000 gallons). (A.G. Ex. 1.0 at p. 19). Moreover, IAWC's own revenue requests in this rate case disclose that it seeks over \$26 million in revenue increases here for Zone 1, while seeking "only" \$3.755 million from Chicago Metro

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in revenue increases. (IAWC Ex. 5.01 SR). In light of the dramatic differences between the two service areas, IAWC needs to demonstrate that the consolidation of the two would benefit the ratepayers with much more detail – detail that it has utterly failed to produce in this proceeding. Thus, the proposed consolidation should **not** be approved, given that the Commission must take into account the impact of this proposed change on the Chicago Metro ratepayers and protect their interests. 220 ILCS 5/9-201(c); Citizens Utility Board, 658 N.E.2d 1235 (Where the ICC heard no evidence on an issue, it could not meet its “duty to protect the interests of ratepayers” because it could not take into account the varying effects of the utility proposal on consumers).

Further, provisions of the Act itself militate against consolidation of service areas, in general. As noted above, the Act requires that the cost of supplying public utility services is allocated to those who cause the costs to be incurred. 220 ILCS 5/1-102(d)(iii). Elsewhere, the Act provides:

No public utility shall, as to rates or other charges, services, facilities or in other respect, make or grant any preference or advantage to any corporation or person or subject any corporation or person to any prejudice or disadvantage. **No public utility shall establish or maintain any unreasonable difference as to rates or other charges, services, facilities, or in any other respect, either as between localities** or as between classes of service.

220 ILCS 5/9-241 (Emphasis added). Thus, the Act itself requires a critical analysis of separate geographic areas, i.e., “localities”, such that this Commission would be better able to determine whether any proposed change from IAWC in a charge, service, facility, or other matter would be unreasonable. By approving the Company’s request for consolidation of the Chicago Metro Water Service Area with Zone 1 without an in-depth analysis of the consequences, this Commission would hamstring itself in ensuring that the terms of the Act are being met.

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Finally, it must be emphasized that the Chicago Metro Water District is unique. It became a division of IAWC when this Commission approved the merger between IAWC and CUCI in its Order in Case 00-0476, dated May 15, 2001. Commission approval was based on the promise of protection for customers in the former CUCI service areas: “From and after the effective date of the Acquisition and until such time as a change(s) is (are) approved by the Commission, Illinois-American will maintain in effect the various rates, rules, regulations, terms and conditions of service to the public heretofore approved by the Commission for each of its service areas, including the area previously served by CUCI.” (Order at p. 5). Further, the Commission required IAWC to file Standardized Rules for the CUCI service areas. (Id.). Pursuant to the Act’s provisions regarding approval of utility reorganizations, the Commission found that the merger with CUCI would not have an adverse rate impact on the retail customers in CUCI’s various service areas. (Order at pp. 44-45). In light of the Act’s prohibition of maintaining any unreasonable differences between localities (220 ILCS 5/9-241), the Commission’s prior order that authorized IAWC to purchase the assets of CUCI indicates that this Commission has a continuing obligation to ensure that the IAWC’s merger with CUCI does not harm ratepayers in the various CUCI service areas. Because the record is devoid of any analysis by IAWC, ICC staff, the Attorney General, or any of the intervenors of any positive consequences of consolidation of the former CUCI service areas (i.e., the Chicago Metro Water District) with Zone 1, the Commission should not authorize the consolidation in this proceeding.

II. The Commission Should Remove the Costs Associated with IAWC's Service Company's Business Transformation Plan from the Rate Base.

IAWC seeks in this proceeding to include in rate base \$27.5 million for the BT project.²

The Company's request should be rejected.

Initially, the BT project is a Service Company program, not an IAWC program. Northstar Audit at IV-1; A.G. Ex. 2.0 Rev. at 26. The Service Company agreement with IAWC, admitted into evidence as AG Cross Exhibit 3, lists essentially the same functions for the Service Company that IAWC witness Twadelle identifies as BT functions. Compare IAWC Ex. 9.00 with AG Cross Ex. 3 at pp. 2-9.

According to the Service Company agreement, which must be approved by this Commission because both IAWC and the Service Company are subsidiaries of the same corporate parent, "All costs of service rendered by the Service Company personnel shall be charged to Water Company [IAWC] based on actual time spent by those personnel. . ." (A.G. Cross Ex. 3 at p. 9, Par. 2.2). IAWC President Teasley and other IAWC witnesses have testified that Service Company expenses are provided to IAWC at cost, with no Service Company profit. (IAWC Ex. 1.00 at p. 26; IAWC Ex. 4.00 at p. 10; IAWC Ex. 6.00R at p. 34; Tr. at 85).

However, IAWC is asking this Commission to allow IAWC to include BT costs in IAWC's rate base, which will result in Illinois consumers paying a profit on the cost of these BT systems. IAWC President Teasley testified that she believed that Service Company equipment, such as computers, are charged to IAWC because they are used by Service Company personnel. Tr. at 86, 103-04. While Article II of the Service Company agreement provides for the pass-

² See IAWC Ex. 4.00 at 2-6 and IAWC Ex. 4.01.

through of office costs and depreciation, it does not provide that IAWC can move those costs into its rate base and earn a return, or profit, from doing so. Moreover, the Service Company agreement prohibits the Service Company from charging IAWC for the Service Company's "general overhead." (AG Cross Ex. 3 at Par. 3.1).

The Commission should remove the BT costs as part of IAWC's rate base because doing so would contravene the Service Company agreement and also allow IAWC to force ratepayers to pay a return on equity, or profit, on them.

III. IAWC's Request for a "Revenue Adjustment Clause" Rider Should Be Denied.

IAWC seeks a "Revenue Adjustment Clause" rider ("RAC"). The RAC, anything but simple, is essentially a series of calculations that essentially guarantees a predetermined level of revenues for IAWC without regard to the quantity of water it sells or delivers. The difference between actual revenues received and target revenues that IAWC expected would be calculated annually, with the difference, subject to a cap of 5% of revenues, reflected as a surcharge to customers for the following year. AG Ex. 1.0 at p. 14.

As set forth by the Attorney General in its Initial Brief and witness Scott Rubin, because profit-making utilities have a monopoly, regulators set the price that they may charge, with the purpose of the regulation to set fair, just, and reasonable prices for the consumers. AG Ex. 3.0 at p. 8; See also Citizens Utility Board, 658 N.E.2d 1235 ("[I]f the rightful expectations of the investor are not compatible with those of the consuming public, it is the latter which must prevail") (Quotations omitted). Regulation fixes the price, while the revenues that the utility receives will vary based upon number of customers and usage rates. AG Ex. 3.0 at p. 8. The regulatory bargain is based on the utility receiving a return on investment in excess of a risk-free

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rate of return to compensate the utility for the risk of consumers buying more or less of its services than projected. AG Ex. 3.0 at p. 8.

The Company's proposed RAC sets this system on its ear. The RAC, if implemented, would shift risk to the ratepayer and get rid of price certainty for the ratepayer. IAWC sets forth no compelling evidence or reason for this dramatic change.

Moreover, for customers in the Chicago Metro service area, which includes users within Bolingbrook, IAWC's residential production costs are much lower than they are elsewhere in the State. (AG Ex. 1.0 at p. 19; see AG Initial Brief at p. 48). The company's proposed rate to Chicago Metro is different from its proposed rates to other service areas (notably, despite the fact that Chicago Metro has the lowest residential production cost, it does not receive the lowest proposed rate). (AG Ex. 1.0 at p. 19; see AG Initial Brief at p. 48). IAWC's profit margins vary in the differing service areas, but the RAC does not take this into account such that members of the Chicago Metro service area may end up paying for a decrease in usage in other service areas despite the fact that the usage in Chicago Metro stayed the same or increased. AG Ex. 1.0 at p. 20. Having rates set in this fashion appears faulty on its face.

Moreover, the RAC violates the Commission's test year rules and established ratemaking principles, which are based upon an overall evaluation of each aspect of a utility's cost of service and each source of revenue. AG Ex. 1.0 at pp. 16-17. A "just and reasonable" rate "does not insure that the business shall produce net revenues." Federal Power Comm'n v. Hope Natural Gas Co., 320 U.S. 591 (1944).

The RAC also constitutes improper single issue rate making, which is prohibited. A. Finkl & Sons v. ICC, 250 Ill.App.3d 317, 329, 620 N.E.2d 1141 (1st Dist. 1993).

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There is no need for an automatic annual revenue guarantee for IAWC, and the Company has failed to carry its burden of proof that such a radical departure is justified.

IV. The Commission Should Reject IAWC's Attempt to Collect Excessive Charges for the Northstar Audit of IAWC's Service Company Charges.

Because of severe concerns about the enormous increases in recent years from the Service Company, the Commission required an audit of IAWC's Service Company fees. IAWC seeks to recover \$1.114 million in this proceeding to cover the costs of the audit. (IAWC Ex. 4.00 at 16). Although the cost of the audit is recoverable (220 ILCS 5/8-102), IAWC is seeking the recovery of multiple costs that are above and beyond the costs of the audit itself. IAWC has failed to prove its burden on the total amount of audit costs that it seeks to recover.

Initially, as pointed out by the A.G.'s Initial Brief, IAWC seeks to recover over 180% more than the actual costs of the audit as its own costs. The audit cost \$392,100, but IAWC seeks to recover an additional \$722,000, and has failed to prove that this amount was reasonably incurred. See Peoples Gas Light & Coke v. Slattery, 373 Ill. 31, 66 (1940). Included in the additional amounts are \$211,000 for IAWC to hire an audit consultant, \$225,000 in Service Company labor costs, \$25,000 for a data room, \$250,000 in additional legal costs, and \$10,000 for travel. IAWC Ex. 4.00 at 16. As argued by the Attorney General, these costs should be treated as a normal cost of doing business, i.e., as O&M expenses incurred between rate cases without any specific Commission authorization for deferral. AG Ex. 4.00 Rev. at 35.

The request for Service Company employee reimbursement in this regard is particularly jarring. At the evidentiary hearing, IAWC admitted that only \$1,000 of the \$261,000 submitted for "internal services" stemmed from IAWC's own employees. Tr. at 302. There was no justification given by IAWC as to why it decided to use the Service Company employees (at a

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higher cost to ratepayers if the proposed expense is approved) in relation to the audit, as opposed to its own employees. That decision seems to highlight the need for the audit, and future similar audits, in the first place. IAWC should not be rewarded in this rate case for its failure to minimize its audit costs.

As also pointed out by the Attorney General, IAWC's initial projections for its audit costs were from \$400,000 to \$600,000 (AG Cross Ex. 8), yet it actually spent \$1.114 million. The large increase was not explained by IAWC and is "indicative of the lack of cost control and the dangers of unrestrained use of the affiliated Service Company." (AG Initial Brief at p. 33).

The Commission should reject the Company's attempts to include in rates the unreasonable and excessive costs that the Company incurred in responding to the Commission-ordered audit of the Service Company fees.

V. The Financially Negative Impacts of IAWC's Filing a Consolidated Tax Return When Its Parent Has No Taxable Income Should Be Taken Into Account When Setting Rates in this Case and in the Future.

Bolingbrook adopts the Attorney General's positions on IAWC's tax returns. IAWC files a consolidated tax return at the parent level, and its parent has no taxable income. Thus, IAWC is not taking advantage of the "Section 199" deduction. Further, this Commission should follow the lead of other states' commissions and implement a mechanism to capture consolidated tax savings for Illinois consumers, particularly where IAWC has failed to take advantage of available tax savings in Illinois.

CONCLUSION

With respect to IAWC's proposed consolidation of the Chicago Metro Water District with Zone 1, the Company has not proven that the consolidation is in the best interests of the

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ratepayers, and, indeed, there are substantial reasons why it should not be approved. There simply has been insufficient proof presented by the Company given the dictates of the Public Utility Act, which militates in favor of keeping separate geographic service areas. The Commission should reject this consolidation attempt in this proceeding. If IAWC desires to bring a separate proceeding to analyze all of the ramifications of the proposed consolidation, so be it, but, clearly, it has not satisfied its burden of proof here.

Further, the BT project amounts should not be included in the rate base because the BT project provides the same functions as provided for IAWC by its Service Company. Treating the BT costs as IAWC rate base violates the terms of the Service Company agreement with IAWC.

This Commission should also reject IAWC's radical request for the imposition of the RAC, which guarantees IAWC's a certain amount of revenues regardless of the water that IAWC actually delivers and sells, thus impermissibly shifting risk from IAWC to the consumer.

The Commission should reject IAWC's attempt to collect excessive fees it allegedly incurred in relation to the service company audit that this Commission previously ordered. There was no explanation given as to why the fees, anticipated to be between \$400,000 and \$600,000, jumped to \$1.115 million, nor has IAWC proven that the excessive fees should be shouldered by the ratepayers.

Finally, Bolingbrook adopts the Attorney General's positions on IAWC's tax returns. IAWC files a consolidated tax return at the parent level, and its parent has no taxable income. Thus, IAWC is not taking advantage of the "Section 199" deduction. Further, this Commission should follow the lead of other states' commissions and implement a mechanism to capture

consolidated tax savings for Illinois consumers, particularly where IAWC has failed to take advantage of available tax savings in Illinois.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I, Jeffrey M. Alperin, hereby certify that a copy of the foregoing Reply Brief was served upon all parties on the ICC eDocket Service List by electronic means on this 29th day of June, 2012.

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